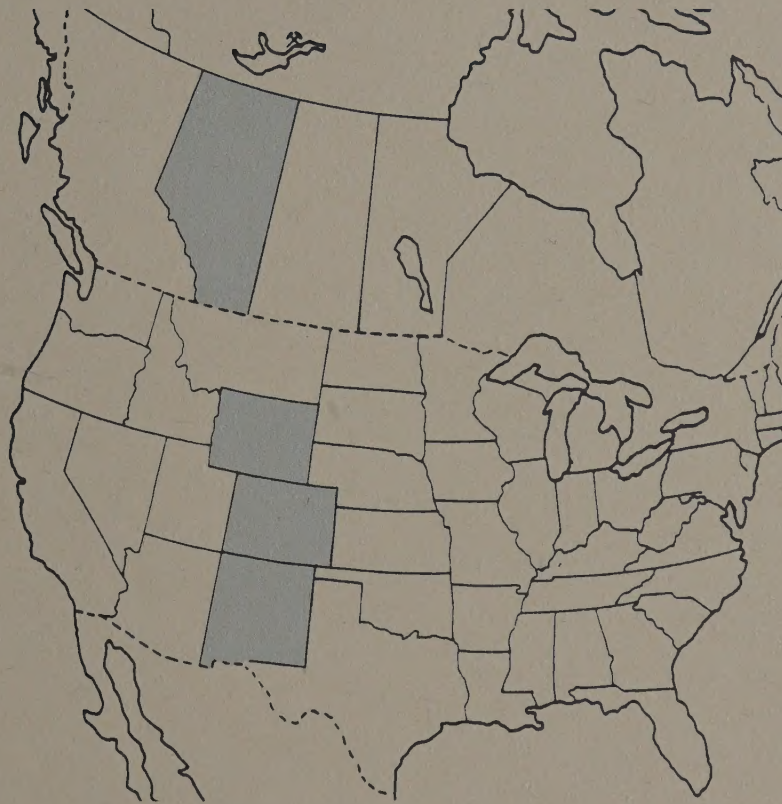


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PEOPLES OIL LIMITED



1986 Annual Report

Notice of Annual Meeting

The Annual Meeting of the shareholders of
Peoples Oil Limited will be held on
Monday, April 27, 1987 at 9:30 a.m.
in the Viking Room at the Calgary Petroleum Club,
319 - 5th Avenue S.W., Calgary, Alberta.

PRESIDENT'S REPORT

To the Shareholders

On behalf of the Board of Directors, it is my pleasure to submit your Company's Annual Report covering the period from our last interim report to the present. This report outlines some of the important developments which have affected the Company.

South Cole Creek Project

There has been no additional drilling at South Cole Creek.

The oil-producing properties continue to produce trouble-free. Daily rates of production have been cut back in anticipation of future increases in crude oil prices.

Our net income for 1986 decreased considerably from 1985, as a result of the impact of the crude oil price drop early in 1986.

In September, October and November of 1986, crude oil prices increased from approximately \$14.00 U.S. per barrel to \$17.00 U.S. per barrel. The price remains at \$17.00 U.S. per barrel which is still well below the December, 1985 value of \$28.00 U.S. per barrel.

We are confident that the worst is over and that crude oil prices will stabilize around \$16.00 to \$20.00 U.S. per barrel in the second and third quarters and then gradually increase in late 1987.

We are attempting to obtain new lands on trend with our present leases in the South Cole Creek area and we have been negotiating with one landowner for approximately six months.

Drilling costs have continued to decline and are currently less than fifty percent of the 1985 prices. From a project economics standpoint, the decrease in drilling costs more than makes up for the decrease in crude oil prices.

V-Two Draw Project

Special pressure tests were commenced on the Valentine #1 well late in 1986 and these pressure tests indicate that the oil being produced is from a reservoir which covers a considerable aerial extent. The pressure tests also indicate that the Valentine #1 well, which is the only producing well on this property, was severely damaged during completion. Accordingly, it is our plan to stimulate the well early in the second quarter of this year. If the stimulation results in a much improved producing rate, then consideration will be given to the drilling of a new well. Peoples holds a 27 percent interest in this property which covers approximately 2,000 acres.

SDC Project

Peoples, together with a group of other companies, was the successful bidder for the rights to the SDC oil and gas properties in the U.S. Peoples' share is 20 percent and it is expected that the deal will be closed by May, 1987. The properties consist mainly of producing gas condensate wells in south-west Colorado and dry gas properties in north-central Colorado. There are also undrilled but potentially productive oil and gas properties in New Mexico.

It is expected that the payout of the SDC acquisition will occur in less than two years.

Bear Creek Project

Peoples, together with a group of other companies, was the highest bidder on certain leases held by Mobil Oil in the Bear Creek area of central Wyoming. The Mobil Bear Creek properties contain a flowing gas condensate well which has produced over 530,000 barrels of condensate and 3 BCF

We are awaiting a decision from Mobil Oil as to whether or not they will agree to the sale, since they reserved their right to accept or decline any offers.

Chevron Rocky Mountain Projects

Amoco and Texaco Projects

R. 76W.

TP
35
N.

TP
35
N.

TP
34
N.

TP
34
N.

R. 76W.

LEGEND

PEOPLES OIL INC. LAND

• OIL WELL

◊ SUSPENDED WELL

◇ DRY & ABANDONED WELL

— FIELD BOUNDARY

PEOPLES OIL INC.

SOUTH COLE CREEK & V-TWO DRAW
CONVERSE CO., WYOMING
DAKOTA SAND WELL MAP

MARCH, 1967

0 1/2 1 1 1/2 MILES

Soda Lake Project

Peoples and its partners have been offered an opportunity to drill a step-out well in the Soda Lake area of central Wyoming, approximately 12 miles west of South Cole Creek. If a deal can be struck with the owners of the lease, the test well will probably be commenced in the fourth quarter of 1987. This test well would be a direct offset to important oil production.

Other Projects

Peoples and its partners are actively studying about 20 projects in the Rocky Mountain area at this time. These projects are close-in with high potential for crude oil development. Peoples and its partners are also attempting to obtain inexpensive, long-term trend acreage which could be even more valuable with a return to higher crude oil and natural gas prices.

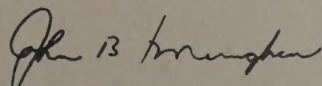
All in all, we have a very active year planned for 1987, as we believe that this is a most opportune time to acquire reserves of oil and gas at reasonable prices.

Finances

As can be seen from our financial statements, our working capital position continues to grow and the company is in good financial health.

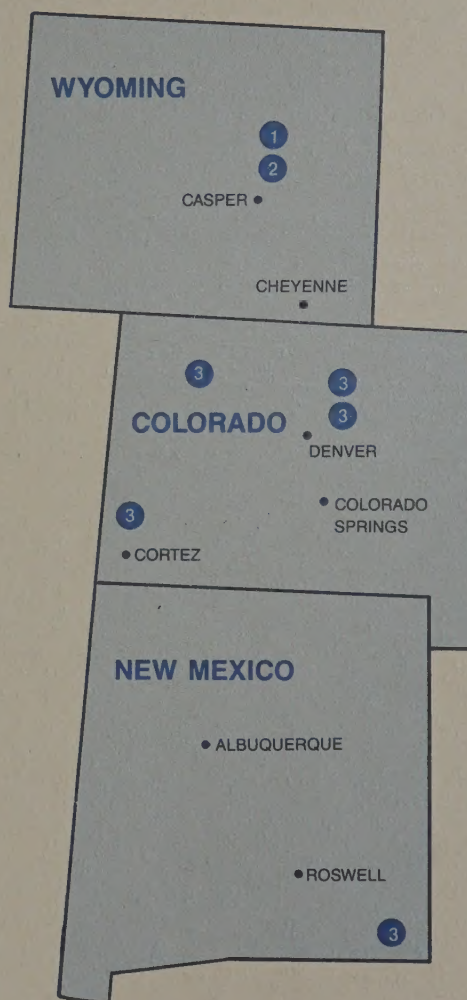
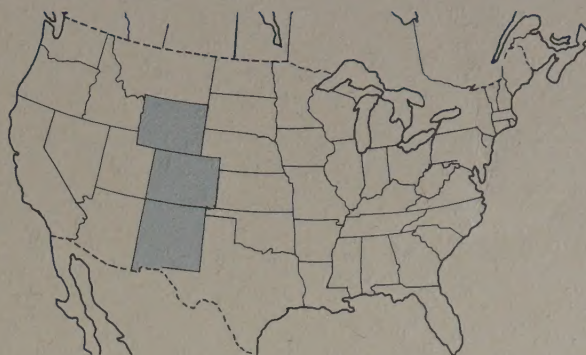
I would like to take this opportunity to thank our staff and all of our supporters for their continued help during the past year.

On behalf of the Board



John B. Maughan, P.Eng.
President and Chief Executive Officer

Calgary, Canada
March 23, 1987



PEOPLES OIL INC.

LEGEND:

- ① V-Two Draw
- ② South Cole Creek
- ③ SDC

FINANCIAL STATEMENTS

Auditors' Report

To the Shareholders of Peoples Oil Limited

We have examined the consolidated balance sheet of Peoples Oil Limited as at October 31, 1986 and the consolidated statements of income and retained earnings and changes in financial position for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, these consolidated financial statements present fairly the financial position of the company as at October 31, 1986 and the results of its operations and the changes in its financial position for the year then ended in accordance with generally accepted accounting principles applied, except for the change in accounting policy as described in Note 2, on a basis consistent with that of the preceding year.

Peat, Marwick, Mitchell & Co

Chartered Accountants

Calgary, Canada
January 16, 1987

Consolidated Balance Sheet as at October 31, 1986

(with comparative figures for 1985)

| | 1986 | 1985 |
|---|--------------------|--------------------|
| Assets | | |
| Current assets: | | |
| Cash and term deposits | \$ 949,062 | \$ 590,868 |
| Inventories | 33,266 | 32,474 |
| Due from Mon-Oil Inc. | 64,104 | 93,052 |
| Accrued interest receivable | 1,835 | 1,912 |
| Total current assets | 1,048,267 | 718,306 |
| Petroleum and natural gas properties, at cost | 1,071,469 | 1,011,554 |
| Less accumulated depletion and depreciation | 556,540 | 384,074 |
| | 514,929 | 627,480 |
| Other | 3,375 | 3,335 |
| | <u>\$1,566,571</u> | <u>\$1,349,121</u> |
| Liabilities and Shareholders' Equity | | |
| Current liabilities: | | |
| Accounts payable | \$ 215 | \$ 412 |
| Income taxes payable | 26,000 | 6,253 |
| Deferred income taxes | 57,000 | - |
| Total current liabilities | 83,215 | 6,665 |
| Deferred income taxes | 254,745 | 241,753 |
| Shareholders' equity: | | |
| Share capital (Note 5) | | |
| Authorized: | | |
| 10,000,000 common shares without nominal or par value | | |
| Issued: | | |
| 1,955,003 common shares | 697,300 | 697,300 |
| Foreign currency translation account | 46,928 | 40,912 |
| Retained earnings | 484,383 | 362,491 |
| | <u>1,228,611</u> | <u>1,100,703</u> |
| | <u>\$1,566,571</u> | <u>\$1,349,121</u> |

On behalf of the Board:

John B. Thompson

Director

See accompanying notes.

Ken Shuman

Director

Consolidated Statement of Income and Retained Earnings *year ended October 31, 1986*

(with comparative figures for 1985)

| | 1986 | 1985 |
|--|------------------|------------------|
| Revenue: | | |
| Oil and gas | \$434,330 | \$834,928 |
| Royalty | 33,927 | 70,400 |
| Interest | 69,176 | 32,199 |
| Foreign currency gain | 2,889 | 22,298 |
| | <u>540,322</u> | <u>959,825</u> |
| Expenses: | | |
| Production costs | 62,154 | 184,714 |
| Joint venture operating costs | 65,565 | 72,830 |
| Depletion and depreciation | 165,650 | 239,556 |
| General and administrative | 39,569 | 44,912 |
| | <u>332,938</u> | <u>542,012</u> |
| Income before income taxes | <u>207,384</u> | <u>417,813</u> |
| Income taxes: (Note 4) | | |
| Current | 26,000 | 6,197 |
| Deferred | 59,492 | 163,919 |
| | <u>85,492</u> | <u>170,116</u> |
| Net income | <u>121,892</u> | <u>247,697</u> |
| Retained earnings, beginning of year | <u>362,491</u> | <u>114,794</u> |
| Retained earnings, end of year | <u>\$484,383</u> | <u>\$362,491</u> |
| Earnings per share | <u>\$ 0.06</u> | <u>\$ 0.13</u> |

Consolidated Statement of Changes in Financial Position *year ended October 31, 1986*

(with comparative figures for 1985)

| | 1986 | 1985 |
|---|------------------|------------------|
| Operating activities: | | |
| Net income | \$121,892 | \$247,697 |
| Items not affecting working capital: | | |
| Depletion and depreciation | 165,650 | 239,556 |
| Deferred income taxes | 8,853 | 163,919 |
| Net changes in non-cash working capital balances | <u>104,783</u> | <u>66,114</u> |
| | <u>401,178</u> | <u>717,286</u> |
| Investing activities: | | |
| Additions to plant and equipment | (42,009) | (263,452) |
| Effect of currency translation adjustments on cash flows | (975) | (7,614) |
| | <u>(42,984)</u> | <u>(271,066)</u> |
| Increase in cash and term deposits during the year | <u>358,194</u> | <u>446,220</u> |
| Cash and term deposits, beginning of year | <u>590,868</u> | <u>144,648</u> |
| Cash and term deposits, end of year | <u>\$949,062</u> | <u>\$590,868</u> |

See accompanying notes.

Notes to Consolidated Financial Statements *as at October 31, 1986*

1. Significant accounting policies:

a) Petroleum and natural gas properties:

The Company follows the full-cost method of accounting for oil and gas operations in accordance with the Canadian Institute of Chartered Accountants Accounting Guideline "Full Cost Accounting in the Oil and Gas Industry".

All costs are subject to depletion. The Company has not capitalized any general and administration expenses for the year.

b) Foreign currency translation:

The accounts of the United States subsidiary, which is accounted for as self-sustaining operation, have been translated into Canadian dollars on the following basis:

- (i) Assets and liabilities at the rate of exchange at the balance sheet date;
- (ii) Revenue and expenses at the average rate of exchange for the year.

All gains and losses arising from foreign currency translation are included in the foreign currency translation account.

c) Joint venture accounting:

Substantially all of the Company's exploration activities are conducted jointly with others and accordingly these financial statements reflect only the Company's proportionate interest in such activities.

d) Inventories:

Inventories are recorded at the lower of cost (first in first out) and replacement cost.

2. Change in accounting policy:

During the year, the Company prospectively adopted the method of accounting for its petroleum and natural gas properties in accordance with the Canadian Institute of Chartered Accountants Accounting Guideline "Full Cost Accounting in the Oil and Gas Industry". Capitalized costs are limited to undiscounted estimated future net revenues, using prices at October 31, 1986, from production of proved reserves, after applicable income taxes and general and administrative expenses.

3. Related party transactions:

The Company participates in a joint venture with Mon-Oil Inc., a wholly-owned subsidiary of Mon-Oil Limited, a shareholder. The terms of the joint venture are considered comparable to similar transactions with non-related parties. Substantially all capital expenditures incurred during the year relate to this joint venture.

The Company has earned \$1,186 (1985 - \$14,210) of interest income on the amount due from Mon-Oil Inc.

Mon-Oil Limited has provided management services to the Company during the year in the amount of \$10,008 (1985 - \$9,325).

4. Income Taxes:

| | 1986 | 1985 |
|---|------------------|------------------|
| Provision for income taxes based on combined basic Canadian federal and provincial tax rate of 48.8% (1985 - 47%) | \$101,203 | \$196,372 |
| Increase (decrease) in income taxes resulting from: | | |
| Lower effective income tax rate on earnings of foreign subsidiary | (18,554) | (17,798) |
| Other | 2,843 | (8,458) |
| | <u>\$ 85,492</u> | <u>\$170,116</u> |

Notes to Consolidated Financial Statements (continued)

5. Share capital:

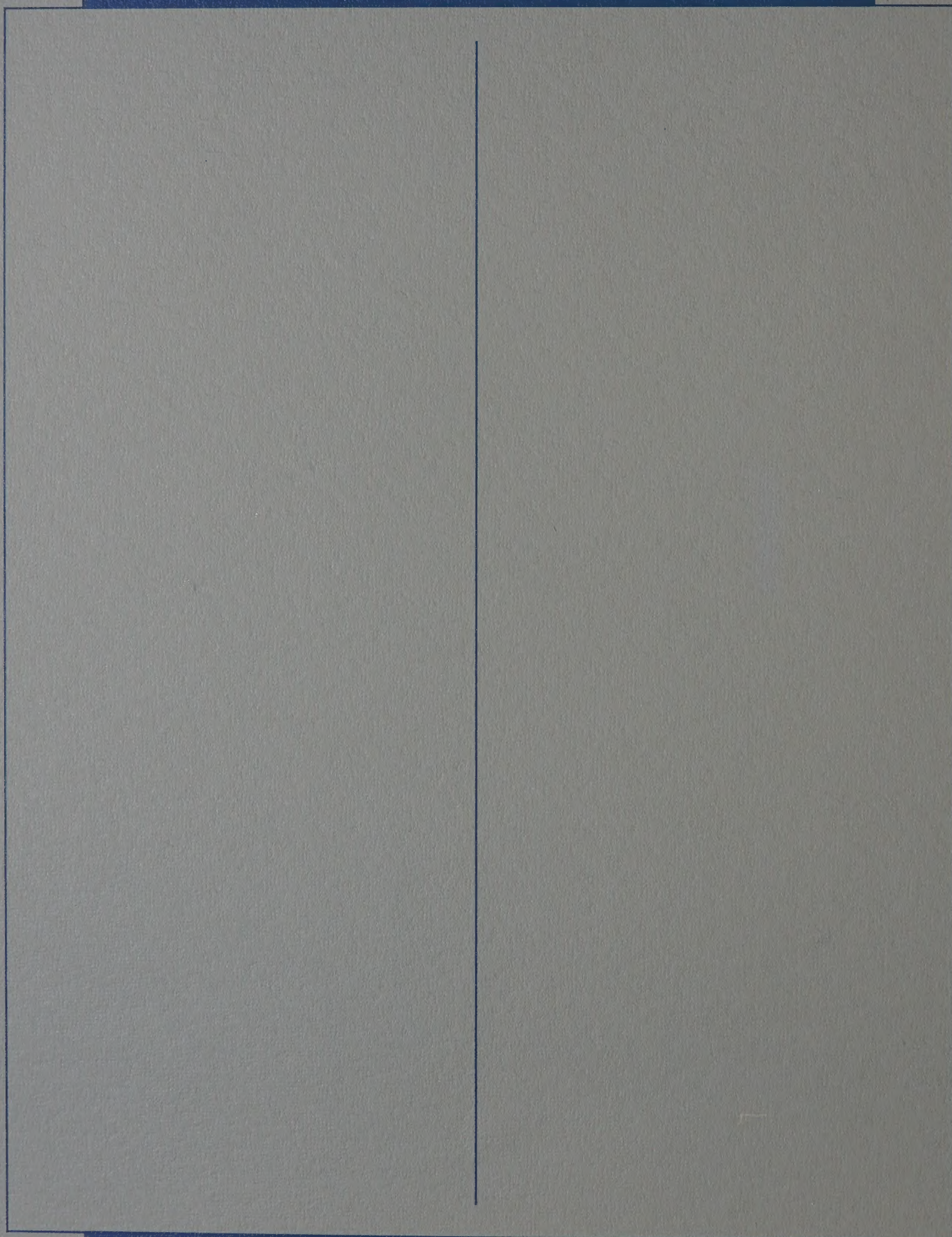
Stock purchase options:

| Expiry Date | Option Price | Number Granted | Number Exercised | Number outstanding 1985 and 1986 |
|---------------|--------------|-------------------|---------------------|--|
| March 3, 1988 | \$0.35 | 155,000 | - | 155,000 |

6. Segmented information:

The Company operates principally as an oil and gas exploration and development company.

| | 1986 | | |
|---|------------------|------------------|--------------------|
| | Canada | United States | Total |
| Income: | | | |
| Production | \$ - | \$468,257 | \$ 468,257 |
| Interest | 65,676 | 3,500 | 69,176 |
| Foreign currency gain | 2,889 | - | 2,889 |
| | <u>68,565</u> | <u>471,757</u> | <u>540,322</u> |
| Expenses: | | | |
| Production costs | - | 62,154 | 62,154 |
| Joint venture operating costs | - | 65,565 | 65,565 |
| Depletion and depreciation | - | 165,650 | 165,650 |
| | <u>-</u> | <u>293,369</u> | <u>293,369</u> |
| Segmented income before the following | <u>\$ 68,565</u> | <u>\$178,388</u> | <u>246,953</u> |
| General and administrative | | | 39,569 |
| Income taxes | | | 85,492 |
| Net income | | | <u>\$ 121,892</u> |
| Identifiable assets | <u>\$775,894</u> | <u>\$790,677</u> | <u>\$1,566,571</u> |
| | 1985 | | |
| | Canada | United States | Total |
| Income: | | | |
| Production | \$ - | \$905,328 | \$ 905,328 |
| Interest | 17,989 | 14,210 | 32,199 |
| Foreign currency gain | 22,298 | - | 22,298 |
| | <u>40,287</u> | <u>919,538</u> | <u>959,825</u> |
| Expenses: | | | |
| Production costs | - | 184,714 | 184,714 |
| Joint venture operating costs | - | 72,830 | 72,830 |
| Depletion and depreciation | - | 239,556 | 239,556 |
| | <u>-</u> | <u>497,100</u> | <u>497,100</u> |
| Segmented income before the following | <u>\$ 40,287</u> | <u>\$422,438</u> | <u>462,725</u> |
| General and administrative | | | 44,912 |
| Income taxes | | | 170,116 |
| Net income | | | <u>\$ 247,697</u> |
| Identifiable assets | <u>\$526,166</u> | <u>\$822,955</u> | <u>\$1,349,121</u> |



Officers and Directors:

John B. Maughan
President & Director

Sherry L. Cremer
Secretary & Director

H. Norman Stewart
Treasurer & Director

John I. Maughan
Vice President Operations & Director

Kenneth R. Murray
Director

Brett P. Maughan
Director

***Head Office and
Registered Office:***

1410 Elveden House
717 - 7th Avenue S.W.
Calgary, Alberta T2P 0Z3
Phone: (403) 269-7717

Auditors:

Peat, Marwick, Mitchell & Co.
2500 Scotia Centre
700 Second Street S.W.
Calgary, Alberta T2P 2W2

Bank:

The Royal Bank of Canada
Main Branch
339 - 8th Avenue S.W.
Calgary, Alberta T2P 1C4

***Registrar and
Transfer Agent:***

The Canada Trust Company
505 - 3rd Street S.W.
Calgary, Alberta T2P 3E6
Phone: (403) 294-3333

Solicitors:

Parlee McLaws
21st Floor
The Alberta Stock Exchange Tower
300 - 5th Avenue S.W.
Calgary, Alberta T2P 3C4

DuMoulin, Black
1004 - 595 Howe Street
Vancouver, B.C. V6C 2T5

Exchange Listing:

Vancouver Stock Exchange Symbol PPS

Authorized Capitalization:

10,000,000

Shares Issued:

1,955,003

